Supreme Court, U.S.
FILED

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No. 95- 516 SEP 27 1995

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In The

Supreme Court of the United States

October Term, 1995

JOHN R. SPICER,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Should this Court grant certiorari to resolve a conflict of authority in the federal courts of appeal, to determine whether a debt on a promissory note arising out of a settlement agreement, given in consideration of an express release against any future claims on pre-existing causes of action based on fraud, can later be held to be a non-dischargeable debt for money, property, or services obtained by false pretenses, a false representation, or actual fraud, pursuant to § 523(a)(2)(A) of the United States Bankruptcy Code?

2. Did the Court of Appeals err in affirming the Bankruptcy Court's grant of summary judgment in favor of the United States, when the only evidence of record to support the Court's decision that Petitioner's misrepresentations were, as a matter of law, the proximate cause of the government's loss was:

(a) Petitioner, a seller of real estate misrepresented the downpayments made by buyers, so that the United States government issued mortgage insurance to the buyers in reliance upon, among other things, such false statements;

(b) the buyers, for reasons unknown and unproven, subsequently defaulted on their mortgage obligations;

(c) the government suffered losses when it made insurance payments to the mortgagees on the loan guarantees.

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Petitioner John R. Spicer respectfully prays that a writ of certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit issued in the above proceeding on June 30, 1995.

OPINIONS BELOW

The United States of America filed an adversary proceeding against the Petitioner, John R. Spicer, in the United States Bankruptcy Court for the District of Columbia, seeking to declare $339,000 in debt on promissory notes held by the government non-dischargeable in Spicer's Chapter 7 bankruptcy case. The bankruptcy court granted the United States' motion for summary judgment, holding that the debt represented nondischargeable money, property, or services obtained by false pretenses, a false representation, or actual fraud. The bankruptcy court's opinion is reported at 155 B.R. 795 (Bankr. D.D.C. 1993) (Appendix A, App. 1-18). Spicer appealed to the United States District Court for the District of Columbia, which affirmed the lower court in an unreported opinion (Appendix B, App. 19-25). Petitioner sought review of the decision of the district court in the United States Court of Appeals for the District of Columbia Circuit, which affirmed the judgment of the district court on June 30, 1995, in an opinion reported at 57 F.3d 1152 (D.C. Cir. 1995 (Appendix C, App. 26-46). Petitioner now seeks review of the judgment of the court of appeals.

STATEMENT OF JURISDICTION

The opinion and judgment of the United States Court of Appeals for the District of Columbia Circuit was entered on June 30, 1995. This Court's jurisdiction to review the judgment of a United States court of appeals is invoked under 28 U.S.C. § 1254(1).

Original subject matter jurisdiction for the adversary proceeding filed by the government in the United States District Court is conferred by 28 U.S.C. § 1334(a). Reference to the United States Bankruptcy Court was made pursuant to Local Rule 601 of the Rules of the United States District Court for the District of Columbia, and pursuant to 28 U.S.C. § 157(a). The proceeding to determine dischargeability of a debt is a core proceeding, heard by the bankruptcy court pursuant to 11 U.S.C. § 157(b)(2)(I), under the authority conferred by 11 U.S.C. § 523.

STATUTORY PROVISIONS

11 U.S.C. § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt--

* * *

> (2) for money, property, services, or for an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

STATEMENT OF THE CASE

On October 26, 1990, the Petitioner, John R. Spicer, entered into a settlement agreement with the United States, wherein he executed two promissory notes, in amounts totaling $339,000. The notes were given by Spicer, a real estate broker and speculator, in consideration for an express release from any and all future claims or causes of action by the government arising out of Spicer's participation in various real estate transactions in which buyers financed their purchases with mortgages insured by the U.S. Department of Housing and Urban Development (HUD). The settlement agreement, among other things, contained a denial of liability on the part of Spicer, and also contained a release by Spicer as to all claims he might have against the government arising from his real estate transactions.

The claims by the government against Petitioner arose out of a criminal investigation. On October 3, 1989, Spicer entered a guilty plea before the United States District Court for the District of Columbia to one count of Interstate Transportation by Fraud, and was sentenced to a short period of incarceration.

As part of the plea arrangement between Spicer and the government, a written "Factual Proffer" was submitted to the court. Spicer admitted to participation, as a seller of inner city real estate, in 81 transactions between 1983 and 1985 in which misrepresentations were made on settlement sheets so as to overstate the amount of down payments actually made by the buyers of those properties. HUD insured the buyers' mortgages on these properties based, among other things, on the false information contained in the settlement statements. Some of the buyers in those transactions subsequently defaulted on their mortgage obligations. As part of the

proffer made to the court, the United States specifically stated that it was not contending that the defaults on the FHA insured mortgages were the result of Mr. Spicer's conduct for which he was pleading guilty.

Subsequently, Petitioner and the government entered into a global settlement agreement to settle all of the pending civil claims by the United States against Spicer under the False Claims Act and at common law. The settlement agreement entered into between Spicer and the United States, on October 26, 1990, among other things, fixed Spicer's liability to the government in the amount of $339,000 payable in two promissory notes executed by Petitioner. The agreement contained mutual releases. Spicer specifically denied liability in the agreement as to the civil claims of the United States.

On July 29, 1992, John R. Spicer filed a voluntary petition under Chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Columbia, Case No. 92-00848, seeking, among other things, to discharge his liability on the previously mentioned promissory notes to the United States.

On October 29, 1992, the United States of America filed a single count adversary proceeding in the bankruptcy court, seeking a determination that the $339,000 owed by Spicer to the United States under the promissory notes were nondischargeable in bankruptcy, pursuant to 11 U.S.C. § 523(a)(2)(A), as money or property obtained by fraud. Both Spicer and the United States filed motions for summary judgment, each party alleging that, as a matter of law, the debt was either dischargeable or nondischargeable. The government filed a set of 12 Exhibits with its motion, and asserted a set of facts to which Spicer stipulated, with certain exceptions.

On June 29, 1993, the Bankruptcy Court (Teel, J.) granted the United States' Motion for Summary Judgment and handed down a lengthy decision in support thereof. *In re Spicer*, 155 B.R. 795 (Bankr. D.D.C. 1993) (Appendix A, App.1-18). Spicer filed a timely appeal from that Order. On April 29, 1994, the United States District Court for the District of Columbia (Norma H. Johnson, J.) issued a Memorandum Opinion affirming the bankruptcy court (Appendix B, App. 19-25). Spicer noted an appeal to the United States Court of Appeals for the District of Columbia Circuit, seeking review of the decisions of the district court and bankruptcy court. On June 30, 1995, the Court of Appeals (Wald, J.) issued an opinion affirming the decision of the district court. *United States v. Spicer*, 57 F.3d 1152 (D.C. Cir. 1995) (Appendix C, App. 26-46). Petitioner seeks review in this Court of the judgment of the United States Court of Appeals for the District of Columbia Circuit.

REASONS FOR GRANTING THE WRIT

The opinion of the Court of Appeals below, affirming the decision of the district and bankruptcy courts, is in direct conflict with the recently decided opinion of the United States Court of Appeals for the Seventh Circuit, *Matter of West*, 22 F.3d 775 (7th Cir. 1994), which directly criticized the decision of the bankruptcy court in the case at bar.

Previously, the courts of appeal for the Seventh and Ninth Circuits had held that an obligation on a promissory note given in full satisfaction and release of a pre-existing tort claim for fraud is dischargeable in bankruptcy. *See Maryland Casualty v. Cushing*, 171 F.2d 257 (7th Cir. 1948); *Gonder v. Kelley*, 372 F.2d 94 (9th Cir. 1967). More recently, in a case in which the issue of "release" was not raised, the Eleventh Circuit, in *Greenberg v. Schools*, 711 F.2d 152 (11th Cir. 1983), held that a bankruptcy court can look behind a settlement agreement to determine the underlying character of a debt. In quoting the broad language of *Greenberg*, so as to extend its holding beyond the facts present in that case, the District of Columbia Circuit divined policy implications from § 523(a) of the Bankruptcy Code to vitiate an agreement made by the parties under the law of the District of Columbia that forever waives and bars the United States' fraud claims against the Petitioner.

The *Spicer/West* split of authority, as descendants of two lines of bankruptcy cases originating with *Maryland Casualty* and *Greenberg*, needs to be resolved by this Court so that litigants and members of the bench and bar can rely on uniform interpretation of the Bankruptcy Code throughout the nation.

The *West* court held that when parties, by agreement, settle a claim grounded in fraud, by substituting a new obligation accompanied by a waiver and release of the pre-existing claim, a novation of the original fraud claim occurs. The new obligation on the note is not, therefore, grounded in fraud, and is dischargeable in bankruptcy. The court reaffirmed its previous decision in *Maryland Casualty v. Cushing, supra*, that had established, until recently, the general rule in these types of cases:

> . . . that a promissory note is but the evidence of indebtedness and does not discharge the debtor for which it was given. And, of course, where a note is accepted only as evidence of a pre-existing debt and not as satisfaction or waiver of a tort action, acceptance of such a note will not of itself waive the original cause of action. [citations omitted]. But if it is shown that the note, by express agreement, is given and received, as payment or waiver of the antecedent tort action [citations omitted], and if the agreement is that the note operates to discharge the original obligation and substitute a new one therefor, . . . then the original debt is fully satisfied by the acceptance of the note.

Id. at 258-259.

In the case at bar, The Court of Appeals for the D.C. Circuit squarely rejected *Maryland Casualty* and *West:*

> We decline to follow the *Maryland Casualty* approach, however, because in our view it improperly elevates legal form over substance. . . . The weight of recent authority rejects the *Maryland Casualty* approach because it is contrary to the public policy embodied in § 523(a)(2)(A).

(Appendix C, App. 31).

The D.C. Circuit failed, however, to note the "policy" of the Bankruptcy Code to look to state law for determining the existence and validity of debts. Section 502(b) of the Bankruptcy Code, for example, directs the court, upon the filing of an objection to the claim of a creditor, to determine, after notice and hearing, the amount of the claim,

> except to the extent that--
>
> > (1) such claim is unenforceable against the debtor and property of the debtor under any agreement or applicable law.

In *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156 (1946), Justice Frankfurter, concurring, noted

> . . . the principal inherent in our federal scheme, that the existence of a debt comes about not by federal law but by force of some State law, even though the right to enforce the debt, if it exists, may raise federal questions if bankruptcy ensues. Bankruptcy legislation is superimposed upon rights and obligations created by the laws of the States [citations omitted]. We do not reach considerations of policy in bankruptcy administration until there are rights, created by applicable local law, to be recognized.

Id. at 171. More recently, in a non-bankruptcy case, Justice Scalia, in *O'Melveny & Myers v. FDIC*, 512 U.S. ___, ___, 114 S.Ct. 2048, 2054, 129 L.Ed.2d 67, 74 (1994), wrote,

> In answering the central question of displacement of California law, we of course would not contradict an explicit federal statutory provision. Nor would we adopt a court-made rule to supplement federal statutory regulation that is comprehensive and detailed; matters left unaddressed in such a scheme are presumably left subject to dispositions provided by state law. [citations omitted].

In the instant case, the parties, in a contract made pursuant to local law, privately agreed that the fraud claim was extinguished. Under *Maryland Casualty*, the parties could have easily agreed that the note given by the Petitioner was in consideration of the fraud claims of the United States, and in payment of those claims. Under the terms of such an agreement, the note would survive bankruptcy, and be nondischargeable. The government, with all of its enforcement powers, was able to bring enough pressure on the Petitioner so as to force him to plead guilty to a criminal offense, and serve a period of incarceration. Surely that same government might have drafted a settlement agreement, acceptable to Spicer, that would have preserved its claim for fraud, upon the eventuality of a bankruptcy filing. The change in the form of the government's claim was a substantive change, freely agreed to by the parties, under the provisions of local law.

In this case, the court of appeals, after determining that the release given Petitioner by the United States did not automatically preclude the government from raising fraud in a proceeding to determine dischargeability of a debt, went on to find that the record in this case supported the bankruptcy court's grant of summary judgment. The court of appeals found that the Spicer's misrepresentations on real estate settlement sheets as to the amount of the downpayments paid by buyers obtaining HUD insured mortgage financing was the

proximate cause of the government's loss, when some buyers subsequently defaulted, for unknown reasons, on their mortgage obligations. This holding is also in direct conflict with other decisions by federal courts of appeal.

Unlike the bankruptcy court, the court of appeals below determined that proximate cause was a necessary element of a nondischargeability finding under § 523(a)(2)(A). (Appendix C, App. 35-36). Agreeing that this element of proof applies generally in fraud cases, the court of appeals improperly distinguished the holdings of two other circuit courts of appeal with facts strikingly similar to the case at bar.

In *United States v. Hibbs*, 568 F.2d 347 (3d Cir. 1977), the Third Circuit, in a case under the False Claims Act, held that the seller's misrepresentations regarding heating, plumbing, and electrical systems on HUD loan applications, were not, as a matter of law, the proximate cause of the government's loss, when buyers subsequently defaulted on their mortgages. In *United States v. Miller*, 645 F.2d 473 (5th Cir. 1981), another False Claims Act case, sellers misrepresented, in addition to the amount of downpayments, the financial condition and net worth of the buyers on HUD loan applications. In reversing the district court's grant of summary judgment *in favor of the defendant*, the Fifth Circuit held that such misrepresentations could possibly be a major factor in causing the subsequent defaults. It was not possible, however, based on the scant record at the summary judgment stage of proceedings, to find that such misrepresentations, as a matter of law, were not such a cause. Accordingly, the matter was remanded for trial, to develop a record for the fact finder to determine the causation.

Here, the D.C. Circuit stands *Hibbs* and *Miller* on their heads, and invents facts not contained in the record. The court finds, as a matter of law, that misrepresentations as to heating, plumbing, and electrical systems by sellers cannot be the proximate cause of the government's loss, but misrepresentations as to downpayments are such a cause.

> In that case [*Hibbs*], however, the certifications were merely an ancillary requirement, not material to HUD's determination that the borrowers were financially qualified or had a sufficient personal stake in the property to be unlikely to default.

(Appendix C, App. 41).

> It is undisputed that Spicer intentionally misrepresented buyers' downpayments in order to induce HUD to approve FHA-insured mortgages for parties who otherwise would not qualify; without evidence of adequate downpayments, HUD would have rejected the applications, calculating the risk of default too high.

(Appendix C. App. 42). None of the above assertions by the court are part of the record in this case. The "buyer credit" scheme employed by Spicer, and others, that formed the basis of the government's criminal case against the Petitioner were used as an incentive to induce sales, so that buyers would actually receive money back at settlement. There is no evidence, either in support of, or against the proposition that the buyers might not otherwise have been able to qualify for HUD insured mortgages. Accordingly, the holding here is in direct conflict with the decisions in *Hibbs* and *Miller*, that, at a minimum, mandate a trial on the facts present in the case at bar.

CONCLUSION

The U. S. Court of Appeals for the D.C. Circuit erred when it determined that the United States' release of its fraud claim against Petitioner in a settlement agreement did not bar subsequent relitigation of the fraud claim in the bankruptcy court after Petitioner sought to discharge a promissory note given in consideration of the release. This decision conflicts with recent and longstanding precedent in other circuit courts of appeal. Additionally, the court found, on a scant record, a causal connection between Petitioner's false statements and government losses that other courts of appeal, on similar facts, were unable to find. Accordingly, this Court should grant a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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APPENDIX A -- DECISION OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLUMBIA FILED JUNE 29, 1993

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLUMBIA

In re JOHN R. SPICER, Debtor.

UNITED STATES OF AMERICA, Plaintiff,

v.

JOHN R. SPICER, Defendant.

Case No. 92-00848 (Chapter 7),
Adversary Proceeding No. 92-0250

Decided, June 29, 1993

DECISION REGARDING MOTION FOR SUMMARY JUDGMENT DECLARING DEBT TO THE UNITED STATES OF AMERICA NONDISCHARGEABLE

In this decision, the court holds nondischargeable under 11 U.S.C. §523(a)(2)(A) the debtor's debt to the government under a settlement agreement which compromised government claims arising from the debtor's submitting false statements to obtain government mortgage insurance. In determining to grant summary judgment in favor of the government, the court rejects the debtor's contention (1) that the settlement was a novation, leaving only a contract debt which was discharged, (2) that the government may not rely on the

settlement figure but must show the amount of damages caused by the debtor's admittedly false statements, and (3) that the debtor, who knowingly submitted the false statements for the purpose of obtaining the guarantees, lacked a specific intent to defraud.

FACTS

At the outset it should be emphasized that the debtor does not contest that the settlement was based on his false statements to the government. In the record presented that would be the only reasonable inference.

From 1983 through 1984, the debtor made numerous false statements to the government in order to obtain mortgage insurance from the government for the buyers of various real properties the debtor was trying to sell. These statements falsely represented that the buyers had made the downpayments required by law to participate in a federal mortgage insurance program. In reliance on the false statements, the Department of Housing and Urban Development ("HUD") approved mortgage insurance for the loans: the insurance would be authorized only if a review of the closing documents showed that the statutory requirement of at least a 3% down payment had been met. The debtor either owned the relevant properties by himself or in partnership, or he acted as broker for the owners of the properties receiving a commission for their sale. Of the 81 properties where the debtor made false statements to obtain mortgage insurance, the government has provided evidence that it had to settle claims on 41 of them. As a result, the government alleges, it sustained losses of over $1.8 million.

Appendix A

Because of his conduct, the debtor pled guilty in United States District Court for the District of Columbia to one count of interstate transportation of money obtained by fraud in violation of 18 U.S.C. § 2314. In a factual proffer and again orally at both the entry of the plea agreement and the sentencing hearing, the debtor admitted to making false statements and acknowledged that he did so to obtain mortgage insurance from the government. The false statements the debtor admitted making included not only those statements forming the substance of the one count of fraud to which he pled guilty but also false statements made in applying for mortgage insurance for 80 other properties. The district court accepted the debtor's guilty plea and sentenced him to 4 months in a community correctional center and ordered restitution of $340,000.00, the amount of the debtor's profits from the real property sales. The district court stated that it would be amenable to reducing the amount of restitution if Spicer subsequently reached a civil settlement with the government.

The debtor and the government entered into a settlement agreement compromising all the government's civil claims against the debtor under the False Claims Act ("FCA"), 31 U.S.C. §§ 3729-33, and at common law. These claims were grounded in the debtor's role in submitting applications for federal mortgage insurance from 1980 through 1984. Specifically, the settlement agreement recited that the government "contends . . . that Spicer . . . caused the submission to HUD of at least nine false applications for HUD mortgage insurance, and is liable for losses sustained in connection with claims for HUD mortgage insurance benefits submitted by [the] mortgage holders. . . ." Govt. exh. 10, par. 3. Without admitting liability under the FCA or at common

law, the debtor agreed to pay the government over a 10-year period $339,000.00 in principal plus interest 8.5% per annum on $100,000.00 of the $339,000.00 debtor. The settlement agreement included a release whereby the government agreed it would have no further civil claim, other than tax claims, against Spicer arising out of the claims recited in paragraph 3 of the settlement agreement "or arising out of any other real estate sales transactions in the District of Columbia from 1980 through 1984 in which buyers financed their purchases with mortgages insured by HUD. . . ." Govt. exh. 10, par. 6. Based on the settlement agreement, the district court vacated the restitution order.

The parties viewed the settlement agreement as fixing compensation for HUD's losses. In reaching the settlement agreement the parties focused on Spicer's financial circumstances. At first, subject to Department of Justice approval, HUD agreed that Spicer was to pay only $100,000, payable over a 10-year period in recognition of Spicer's "currently bleak financial situation" (Govt. exh. 8 at 3). In moving to vacate the restitution award, Spicer characterized the settlement agreement as "a global settlement of his civil liability for damages to HUD and the debarment/suspension proceeding initiated by HUD. . . ." *Id.* at 2. Further, Spicer stated that "HUD . . . has agreed to accept the $100,000 . . . as appropriate restitution." *Id.* at 4. Spicer viewed the $100,000 as a recovery of "compensatory damages." *Id.* at 4 n.4 (quoting 18 U.S.C. § 3663(e)(2) (1985 and 1990 Supp.)). In response to a "concern that the settlement agreement did not adequately consider potential improvements in Mr. Spicer's financial situation in the future," Spicer then agreed to a Justice Department proposal to supplement the original proposal by $239,000. Govt. exh. 9 at 2. Spicer reported in

the district court that he and the government "now believe that the sizeable civil settlement agreement that Mr. Spicer has agreed to pay satisfies the Court's interest in compensating HUD under the Restitution Order. . . ." *Id.* at 3. Spicer explicitly believed that the district court had stated that it would be amenable to reducing the amount of restitution if Spicer reached a civil settlement with the government "with respect to any losses sustained by HUD in connection with its FHA guaranteed mortgages." *Id.* at 1.

On July 29, 1992, the debtor filed a petition for bankruptcy under chapter 7 of the Bankruptcy Code. On October 29, 1992, the government filed a complaint for a determination that under 11 U.S.C. § 523(a)(A) the debt for $339,000.00 cannot be discharged in bankruptcy. Summary judgment motions were filed, first by the government on February 26, 1993, and then by the debtor on April 15, 1993.

DISCUSSION

Section 523(a)(2)(A) provides:

(a) A discharge under section 727 . . . does not discharge an individual debtor from any debt --

(2) for money, property, [or] services, . . . to the extent obtained by --

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

Appendix A

I

At the outset, the court must reject the debtor's argument that its debt to the government is only a contract debt that can be discharged. Thus, the court rejects the holdings of *Maryland Casualty Co. v. Cushing*, 171 F.2d 257 (7th Cir. 1948), and *Gonder v. Kelley*, 372 F.2d 94 (9th Cir. 1967) (affirming on the basis of the district court opinion), and their progeny in favor of the analysis set forth in *Greenberg v. Schools*, 711 F.2d 152 (11th Cir. 1983) (affirming on the basis of the district court opinion), for the reasons articulated by the dissent in *Gonder v. Kelley*, 372 F.2d at 94-95 (Koelsch, J., dissenting). See also *Arnold v. Employers Ins. Co. of Wausau*, 465 F.2d 354 (10th Cir. 1972); *Hartford Accident & Indem. Co. v. Flanagan*, 28 F. Supp. 415 (S.D. Ohio 1939).

> Accordingly --
> The fact that [the plaintiff's] claim never matured into a final judgment but was terminated by a settlement agreement should not be controlling. The Bankruptcy Court should inquire into the factual circumstances behind the settlement agreement to ascertain whether or not the debt incurred by [the debtor] was derived from the alleged fraudulent conduct [complained of]. If the court is satisfied that [the debtor's] conduct was fraudulent and did result in the debt that [the plaintiff] claims against him, the debt should not be discharged by the bankruptcy proceeding.

Greenberg v. Schools, 711 F.2d at 156.

Appendix A

II

In opposing the government's motion (on the assumption that Greenberg v. Schools is controlling), the debtor argues that to establish nondischargeability the government must demonstrate that the debtor's fraudulent conduct caused it to suffer damages in the amount of the settlement debt, $339,000.00.

In making this argument, the debtor misperceives the nature of the court's inquiry. In examining the underlying conduct, the court must satisfy itself that the conduct complained of in fact amounted to fraud by the debtor within the meaning of § 523(a)(2)(A). Having satisfied itself that this is the case, the court must then examine the debt established by the settlement agreement ("the settlement debt") to determine to what extent it was intended to be a substitute for any underlying claim for fraud against the debtor. To the extent the settlement debt was attributable to the debtor's fraudulent conduct, it cannot be discharged in bankruptcy, but to the extent the settlement debt was intended to compromise other claims against the debtor, it can be discharged.

In this case all of the settlement debt was based on the debtor's knowingly making false claims to obtain government mortgage insurance: it related only to claims for that fraud. Having satisfied itself that the settlement debt was intended to compromise only fraudulent conduct, the court's inquiry is at an end. For the settlement debt attributable to the debtor's fraud falls within the language of § 523(a)(2)(A). First, it is a "debt" as defined in the Code. 11 U.S.C. § 101(12) (debt means "liability on a claim"). Second, the settlement debt is "for money, property, [or] services, . . . to the extent obtained

by [fraudulent conduct]" in that it resulted from the debtor's fraudulent conduct in obtaining mortgage insurance from the government. *See Hartford Accident & Indem. Co.*, 28 F. Supp. at 419. A fraudulently obtained loan guarantee is "property" for the purposes of § 523(a)(2). *In re Sprague*, 104 Bankr. 352, 355 (Bankr. D. Or. 1989); *In re McShirley*, 79 Bankr. 71, 73 (Bankr. M.D. Fla. 1987); *In re Kovacs*, 42 Bankr. 1, 3 (Bankr. D. Mass. 1982).

The debtor urges that the evidence does not support liability under the FCA for the amount of the debt, citing, for example, *United States v. Hibbs*, 568 F.2d 347, 351 (3d Cir. 1977) (government could not recover under FCA for loss attributable to events caused by or related to the false certifications), and *United States v. Miller*, 645 F.2d 473 (5th Cir. 1981)(government must show that false certifications were the primary cause of the defaults). See also *United States v. Hill*, 676 F. Supp. 1158 (N.D. Fla. 1987) (reaching similar conclusion with respect to FCA as amended in 1982). Other courts impose a lower standard of causation. *United States v. First Nat'l Bank of Cicero*, 957 F.2d 1362, 1374 (7th Cir. 1992) (government must show that it would not have guaranteed loans but for false statements). The debtor's argument, even if the cases he cites were correctly decided, is irrelevant: this is not a proceeding on a FCA claim. It is a proceeding on a settlement fixing the amount recoverable by the government based on admittedly fraudulent conduct. As discussed above, that settlement debt is of the requisite character to escape dischargeability under § 523(a)(2)(A).

The parties settled the underlying claim for fraud for an agreed upon amount. The parties arrived at a mutually acceptable resolution of the underlying claim, and the court

ought not step in now and nullify their efforts unless giving effect to the settlement agreement is somehow inconsistent with § 523. Having agreed to the settlement and having benefitted accordingly, the debtor should be bound by the settlement amount -- at least to the extent it represents a compromise of the claims arising from his fraudulent conduct.

With this analysis in mind, those cases going behind the settlement agreement to determine how much of the settlement debt is nondischargeable can be squared with other cases where no such inquiry was made. Thus, *In re Carnahan*, 115 Bankr. 697 (Bankr. D. Colo. 1990), and *In re Bobofchak*, 101 Bankr. 465 (Bankr. E.D. Va. 1989), both were cases where the settlement debt included amounts attributable to claims other than those giving rise to nondischargeable debts. In these cases, the courts went behind the settlement agreement to determine how much of the settlement debt was nondischargeable.

Similarly, *In re Church*, 69 Bankr. 425 (Bankr. N.D. Tex. 1987), involved a debt arising from a judgment obtained in state court. The state court judgment broke the damages down into their component parts. Because the bankruptcy court determined that certain parts of the damages as listed and described were dischargeable, it declared nondischargeable only those amounts the judgment stated had arisen from the debtor's fraud. *Church*, 69 Bankr. at 434-35.

In another case cited by the debtor, *In re Arterburn*, 15 Bankr. 189 (Bankr. W.D. Okla. 1981), the issue involved was whether the settlement agreement had been fraudulently induced, and not whether the settlement debt compromised claims for fraud against the debtor. *See also In re Schmidt*, 70

Bankr. 634, 645 (Bankr. N.D. Ind. 1986) (noting this distinction on similar facts).

However, no inquiry behind the settlement agreement was made in *In re Guerrerio*, 143 Bankr. 605 (Bankr. S.D.N.Y. 1992), or in *In re Rush*, 33 Bankr. 97 (Bankr. D. Me. 1983). In those cases the settlement agreements resolved suits for fraud against the debtor and no other claims. *Cf. In re Marceca*, 129 Bankr. 371 (Bankr. S.D.N.Y. 1991) (settlement of misappropriation claim); *Hartford Accident & Indem. Co. v. Flanagan, supra* (debt owed under contract of indemnity but resulting from embezzlement).

Moreover, in those cases discussed above where the courts did seek to apportion the settlement debt between nondischargeable and dischargeable amounts, the courts did not examine whether the debtor's conduct in fact caused the plaintiff creditor to suffer losses in the amount of the settlement debt. Instead, the courts -- without visiting the issue of causation -- sought only to determine what part of the debt was intended to compromise the claims for fraud or the like and what part was intended to settle other claims against the debtor.

The whole tenor of the Spicer's settlement negotiations with the government was to fix losses to be repaid by Spicer in order that he might secure a vacating of the restitution award against him. There is no suggestion that punitive damages specifically came into consideration. Nevertheless, this case may be distinguishable from such cases as *Guerrerio*, 143 Bankr. at 610-611 and *Rush*, 33 Bankr. at 97, because the specific arguments the debtors raised in those cases did not question whether the settlement agreements

were for losses attributable to the unquestionable fraud involved. Here the debtor raises that issue and it is theoretically possible that the debtor faced punitive damage claims, not only damage claims for losses caused by the debtor's fraud.

Can the $339,000 settlement amount be viewed as simply fixing the amount of losses HUD suffered? Certainly it could as to the $100,000 component that the debtor himself urged -- before the settlement was increased to $393,000 -- was compensation for losses. The court assumes, without deciding, that the remaining $239,000 could be viewed as for punitive damages as well as for compensatory damages.

Although *Church*, 69 Bankr. at 434-35, and other decisions have held that punitive damages are non-dischargeable under 11 U.S.C. § 523 (a)(2)(A), the contrary holding of *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993), was reached on more persuasive grounds and I hold that punitive damages are part of the debt for property, mortgage insurance, that in its entirety, was obtained by actual fraud.

The settlement agreement states on its face that it compromised the government's claims stemming from the debtor's submission of false information to the government. The debtor's conduct gave rise to claims against the debtor under the FCA and for fraud at common law. Neither party has alleged that the government had any other basis for claims against the debtor. The debtor has pointed to no component of the settlement agreement that could be for other than compensatory damages caused by the false statements or punitive damages. The settlement debt is wholly

attributable to the common law claims for fraud and FCA claims founded on knowingly false statements.

III

There remains for determination whether the underlying conduct complained of by the government amounted to fraud within the meaning of § 523(a)(2)(A). The elements of a § 523(a)(2)(A) exception to discharge have been stated to be:

> 1. The obtaining of money, property, [or] services . . .,
>
> 2. Using a false representation pertaining to a past or present fact,
>
> 3. With knowledge of the representation's falsity, or its assertion as fact with reckless disregard for its truth or falsity,
>
> 4. And an intention to deceive the other party or to induce the other party to act upon the representation,
>
> 5. Reasonable reliance by the creditor upon the misrepresentation, and
>
> 6. Resultant detriment to the creditor.

In re Hanes, 53 Bankr. 868, 871 (Bankr. D. Minn. 1985) (citations omitted); *accord, In re Guerrerio*, 143 Bankr. 605, 611 (Bankr. S.D.N.Y. 1992). Some courts of appeals, however, hold that only actual reliance, not reasonable reliance, is necessary. *In re Allison*, 960 F.2d 481 (5th Cir. 1992); *In re Ophaug*, 827 F.2d 340, 342-43 (8th Cir. 1987).

Appendix A

Another court of appeals holds that only "justifiable reliance" is necessary. *In re Kirsh*, 973 F.2d 1454, 1457-59 (9th Cir. 1992). This unsettled issue need not be resolved here. I assume without deciding that reasonable reliance is required.

Proof of the elements of § 523(a)(2)(A) would suffice to establish liability under the FCA. See 31 U.S.C. § 3729; *see, e.g., United States v. Veneziale*, 268 F.2d 504 (3d Cir. 1959). But since the debtor's conduct amounted to fraud under § 523(a)(2)(A) (as is discussed below), there is no need to decide whether a debtor can discharge a debt based on conduct giving rise to liability under the FCA but not sufficient to establish actual fraud. See 31 U.S.C. § 3739(b) (no proof of specific intent to deceive required for liability under the FCA). Nonetheless, it is important to note that FCA liability is encompassed within liability for actual fraud as the parties' settlement agreement compromised claims under the FCA and for fraud at common law.

The elements for actual fraud are met here as indicated by the following undisputed facts. The debtor has admitted he knowingly submitted false statements to the government for the purpose of inducing the government to insure mortgages. The false information submitted formed the basis for the government agreeing to insure the mortgages, and the government acted reasonably in relying on the false representations contained in the insurance applications: the certification was necessary before an application could be granted and there is no evidence the government was on

warning that the certification was false.[1] The debtor benefitted from the government insuring the mortgages as such insurance facilitated the sale of the real properties, which, in turn, resulted in the debtor obtaining money through sales proceeds or commissions. Finally, because the government agreed to insure the mortgages, it was required to settle numerous claims to its detriment when the various mortgagors defaulted.

With respect to the specific intent element, the debtor maintains that he did not intend to cause the government losses. However, the government does not need to establish such an intent, but only that the debtor submitted false statements to induce the government to insure the mortgages. *Hames*, 53 Bankr. at 871, 872. As the debtor has admitted this was his intent, the intent element is met.

The debtor further maintains that he obtained no benefit, but that the lenders were the only ones to benefit. Some courts appear not to require a benefit by holding that it is of no consequence that third parties (*e.g.*, the purchasers of the HUD-insured properties) arguably were the primary beneficiaries of the fraud; a debtor need not actually procure money or property for himself for the debt to be

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[1]Moreover, to the extent that the Federal nondischargeability reliance element is but a reflection of non-bankruptcy law requirements of reliance to impose liability, *see Kirsh*, 973 F.2d at 1457, it could be argued that the settlement agreement resolved the issue. I have assumed, however, that bankruptcy nondischargeability law imposes a reasonable reliance requirement even if the FCA or common law fraud laws impose no reasonable reliance requirement.

nondischargeable. *In re Mann*, 40 Bankr. 496, 499 (Bankr. D. Mass 1984); *In re Winfree*, 34 Bankr. 879, 882-83 (Bankr. M.D. Tenn.). I need not resolve any conflict in the case law as to whether a benefit is required. For, assuming some benefit to the debtor were necessary, any benefit to the debtor is sufficient for a finding that the debtor obtained property within the meaning of § 523(a)(2)(A). *In re Luce*, 960 F.2d 1277, 1283 (5th Cir. 1992). The benefit to the debtor set forth above (his obtaining sales proceeds or commissions) is sufficient to fulfill this requirement. Looking at it slightly differently, by fraud the debtor procured for third-parties HUD insurance, a form of property, in order to facilitate sales that he desired to accomplish. Thus, the debtor obtained property within the context of § 523(a)(2)(A) when he procured third-party loan guarantees that were for his benefit by facilitating sales in which he had an interest.

The debtor also renews his contention that the government cannot show that the false statements caused it to suffer detriment because any injury resulted from defaults by the mortgagors. For reasons discussed in part II of this decision, the settlement agreement fixed the amount of damages and bars the debtor from requiring the government to put on proof of causation. The amount of liability the parties agreed to under non-bankruptcy law standards of causation is plainly nondischargeable under whatever standards of causation are imposed by Federal bankruptcy nondischargeability law: the latter standards are at least as unfavorable to the debtor as the former.

In an analogous situation this court has held that the entire loss suffered by a creditor is the proper measure of the nondischargeable debt where the creditor advanced monies

wholly in reliance on the debtor's misrepresentations. *In re Hecker*, 95 Bankr. 1 (Bankr. D.D.C. 1989); *see also Birmingham Trust Nat'l Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985). In *Hecker*, the debtor induced the making of a loan for less than adequate security by misrepresenting the nature of the collateral. But it turned out that the collateral would have been worth much less than the loan amount even if the debtor had been truthful. The debtor argued that the nondischargeable debt should be limited to what the lender would have recovered had the debtor been truthful. This court rejected the debtor's argument explaining that "[a] debtor whose misrepresentations induced the lender to make the entire loan in the first place is not entitled to the benefit of the scenario that would have unfolded had the debtor been truthful." 95 Bankr. at 3.

In arguing that the defaulting mortgagors caused the government's losses, the debtor seeks to avoid responsibility for his actions much as the debtor in Hecker did. The government program at issue here required by law that the mortgagor make a downpayment as a pre-condition to obtaining federal mortgage insurance. Thus, absent the debtor's false statements, the government would never have been called upon to pay off the mortgages. The debtor is not entitled to escape or limit liability by laying the blame for the government's losses on the defaulting mortgagors where his false statements resulted in the government agreeing to insure the mortgages in the first place. *Cf. Hecker*, 95 Bankr. at 2-3. Whatever standards of causation the parties applied in fixing the settlement amount of liability under non-bankruptcy law, whether the strict standard of *Hibbs*, or the more liberal standard of *First Nat'l Bank of Cicero*, 957 F.2d at 1374, the debt is nondischargeable under Federal nondischargeability

standards. *See In re Tsamasfyros*, 114 Bankr. 721, 725 (D. Colo. 1990), *aff'd*, 940 F.2d 605, 608 n.4 (10th Cir. 1991) (debtor may not collaterally attack state court's calculation of damages since dischargeability is an all or nothing proposition).

IV

Few cases turn purely upon the binding effect of a settlement. But an analogy readily demonstrates that the settlement agreement should have binding effect here. This case is similar to cases in which the debtor and a creditor enter into a consent judgment in state court and the issue then is whether the consent judgment should be given binding effect. *See Klingman v. Levinson*, 831 F.2d 1292 (7th Cir. 1987); *In re Halpern*, 810 F.2d 1061 (11th Cir. 1987); *In re Pearson*, 120 Bankr. 396 (Bankr. N.D. Tex. 1990). The lack of a judgment here is inconsequential: had the settlement agreement been sued upon, a judgment would have been granted.

The collateral estoppel question presented, when only the settlement agreement or consent judgment is relied upon, is whether by their agreement the parties not only intended to terminate the litigation of claims but also intended to determine finally the issues eventually presented in the dischargeability litigation. *Pearson*, 120 Bankr. at 398. Here the settlement agreement included a disclaimer that Spicer was admitting liability.

However, when the settlement agreement does not establish an intent to fix the character of the debt, other evidence may be received to determine the character of the

debt. A conviction or guilty plea can form the basis for collateral estoppel. *In re Jardula*, 122 Bankr. 649 (Bankr. E.D.N.Y. 1990); *In re Baker*, 108 Bankr. 663 (Bankr. S.D. Ill. 1990). When the nondischargeable nature of the debt is established by collateral estoppel or otherwise, a prior default judgment fixing the extent of the debt is accorded binding effect to prevent relitigation of the amount of the debt. *In re Comer*, 723 F.2d 737, 740 (9th Cir. 1984); *In re Tsamasfyros*, 114 Bankr. 721, 725 (D. Colo. 1990), *aff'd*, 940 F.2d 605 (10th Cir. 1991). Here the character of the debt is unquestionably nondischargeable. The amount of the debt, including all of its incidental components, is thus nondischargeable and has been fixed by the settlement agreement.

CONCLUSION

In short, the court finds, on undisputed material facts, fraud on the part of the debtor and the compromise of claims grounded in that fraud resulting in the settlement debt of $339,000.00 in principal plus interest in accordance with the settlement agreement. Accordingly, the court holds, as a matter of law, that the debt for $339,000.00 is nondischargeable under § 523(a)(2)(A) of the Code. Summary judgment to this effect will be entered in favor of the government.

Dated: June 29, 1993

s/ S. Martin Teel, Jr.
S. MARTIN TEEL, JR.
UNITED STATES BANKRUPTCY JUDGE

APPENDIX B -- MEMORANDUM OPINION OF THE UNITED STATES DISTRICT COURT FILED APRIL 29, 1994

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

JOHN R. SPICER, Appellant,

v.

UNITED STATES OF AMERICA, Appellee.

Civil Action No. 93-1722 (NHJ)

MEMORANDUM OPINION

John R. Spicer appeals from the decision of the United States Bankruptcy Judge S. Martin Teel, Jr., granting summary judgment to the United States. *See In re Spicer*, 155 B.R. 795 (Bankr. D.D.C. 1993). The Bankruptcy Court held that appellant's debt of $339,000.00 was nondischargeable as a matter of law. Upon consideration of the entire record in this case, the Court will affirm the judgment of the Bankruptcy Court.

FACTUAL BACKGROUND

The facts in this case are undisputed, and only a brief recitation is necessary here. Appellant made false statements to the government on eighty-one occasions in order to obtain mortgage insurance from the government for the purchasers of real estate appellant was trying to sell. Appellant misrepresented the amounts of the down payments for the properties that the purchasers had paid him. Based on these

misrepresentations the Department of Housing and Urban Development (HUD) issued the desired mortgage insurance.

Appellant pled guilty to one count of Interstate Transportation of Property Obtained by Fraud on October 3, 1989. He was sentenced to a period of incarceration and ordered to pay restitution to the United States in the amount of $340,000. The restitution amount was subsequently deleted from appellant's sentence, and the parties entered a settlement agreement on October 6, 1990, whereby appellant obligated himself to the United States in the amount of $339,000, payable in two promissory notes. On July. 29, 1992, appellant voluntarily filed a petition under Chapter 7 of the Bankruptcy Code. He argues that his liability to the government under the settlement agreement should, therefore, be discharged, and the United States argues that the underlying fraud that gave rise to the settlement renders appellant's obligations nondischargeable under the Code.

DISCUSSION

A. *Dischargeability in Bankruptcy of Debt Incurred through Settlement of Claim originally Sounding in Fraud*

The Bankruptcy Code does not discharge a debtor from monetary liability to the extent such a "debt" flows from "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523 (a) (2) (A) . The question before the Court is whether this explicit policy to hold bankrupt debtors liable for their fraud applies when such liability arises out of the debtor's settlement agreement with a defrauded creditor. Such a settlement agreement, in

appellant's view, sufficiently disassociates the monetary debt from the underlying fraud as to render the debt dischargeable under the Code.

Relying on a line of case law following *Maryland Casualty Co. v. Cushing*, 171 F. 2d 257 (7th Cir. 1948), appellant argues that the settlement agreement reached between him and the government worked a novation in his case substituting a contractual arrangement for the underlying claim sounding in fraud. The Bankruptcy Court squarely rejected *Maryland Casualty* and its progeny in favor of the regime announced by the Eleventh Circuit in *Greenberg v. Schools*, 711 F.2d 152 (1983). *See* 155 B.R. at 799. The Court agrees with this decision to adopt the *Greenberg* view, which appears less concerned with legalistic distinctions between "tort" and "contract" and more geared toward implementing the policy behind § 523(a)(2)(A). The *Maryland Casualty* regime would encourage a fraudulent debtor to mislead creditors further by promising settlement despite a secret intention to declare bankruptcy in the future. Defrauded parties would sensibly decline to settle or counterclaims lie might have pursued; his suggested use of these facts contravenes *Greenberg's* direction that courts should look beyond formal characterizations of the debt to the underlying fraud. *See* 711 F.2d at 156. In the Bankruptcy Court proceedings, appellant apparently agreed that his debt arose out of his false statements to HUD, *see* 155 B.R. at 797; that court correctly held that this characterization of the debt was not made irrelevant by the subsequent form of his settlement with the government. Assuming that appellant's conduct constituted fraud within the meaning of the Code, the debt that flowed from such fraud was nondischargeable.

Appendix B

B. *Elements of Fraud under Section 523(a)(2)*

As the Supreme Court explained in *Grogan v. Garner*, 498 U.S. 2791, 112 S. Ct. 654, 661 (1991), "Congress amended the Bankruptcy Act in 1970 to make nondischargeability a question of federal law independent of the issue of the validity of the underlying claim." In that case, the Court established a "preponderance of evidence" standard of proof for claims under §523(a) that applies regardless of the standard governing the underlying fraud. Here, because the False Claims Act controls underlying fraud claim,[2] appellant urges this Court to adopt the restrictive view of causation that the Third Circuit applies in False Claims Act cases. *See United States v. Hibbs*, 568 F.2d 347, 349, 351 (3d Cir. 1977) (fraudulent statement must he primary cause of damages under False Claims Act); *but see United States v. First Natl. Bank of Cicero*, 957 F.2d 1362 (7th Cir. 1992) (False Claims Act requires only "but-for" causation). Such a view is contrary to *Grogan*, which establishes the independence of § 523(a) fraud from the requirements of the underlying substantive claim. The Court holds that the False Claims Act standard for fraud is irrelevant to this proceeding.

The Bankruptcy Judge correctly used the 523(a)(2)(A) standard to determine whether Spicer's false statements amounted to nondischargeable fraud, *see* 155 B.R. at 802-03, and the Court concurs with his conclusion, based on analysis of the relevant factors, that the conduct in this case amounted to fraud. With respect to the issue of "causation", the

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[2]The government also compromised common law fraud claims against Spicer.

Appendix B

Bankruptcy Judge concluded that a sufficient nexus existed between appellant's false statements and appellee's losses. His analysis warrants repetition here:

> In arguing that the defaulting mortgagors caused the government's losses, the debtor seeks to avoid responsibility for his actions . . . . The government program at issue here required by law that the mortgagor make a downpayment as a pre-condition to obtaining federal mortgage insurance. Thus, absent the debtor's false statements, the government would never have been called upon to pay off the mortgages. The debtor is not entitled to escape or limit liability by laying the blame for the government's losses on the defaulting mortgagors where his false statements resulted in the government agreeing to insure the mortgages in the first place.

Id. at 803. The Bankruptcy Court appears to have adopted a "but-for" test for causation in this case, yet this passage implicitly recognizes that appellant's misrepresentations were a substantial causal factor of the government's losses. That third parties defaulted on the mortgages in this case does not diminish appellant's role in causing the government's losses beyond where the law will take notice. Without choosing a definitive test for causation, the Court holds that a sufficient nexus between Spicer's misrepresentation and monetary losses to the government has been demonstrated in this case.

Appellant posits that the amount of damages caused by his fraud is lower than the settlement amount in this action, and, not surprisingly, the government contends that its actual damages far exceed the amount of settlement. The parties to

this action agreed upon an amount that fixed the damages appellant owed to the government -- to disregard their compromise as appellant urges would deprive both parties of the boon of certainty that the predetermined settlement amount affords. This Court does not underestimate that boon, and it will no sooner permit appellant to render a smaller portion of his debt nondischargeable than it will allow the government to pursue an amount beyond $339,000. Appellant presents no convincing argument for looking beyond, the settlement agreement, which arose wholly out of claims for fraudulent conduct.

CONCLUSION

The Court finds appellant's other contentions to be without merit. The Bankruptcy Court's judgment must be affirmed. An appropriate order will issue.

/s Norma Holoway Johnson
NORMA HOLOWAY JOHNSON
UNITED STATES DISTRICT JUDGE

Dated: April 29, 1994

Appendix B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

JOHN R. SPICER, Appellant,

v.

UNITED STATES OF AMERICA, Appellee.

Civil Action No. 93-1722 (NHJ)

ORDER

Upon consideration of the opposing briefs in this case, and for reasons explained in a Memorandum Opinion entered on this date, it is this 29th day of April, 1994,

ORDERED that the judgment of the United States Bankruptcy Court for the District of Columbia be, and hereby is, affirmed.

/s Norma Holoway Johnson
NORMA HOLOWAY JOHNSON
UNITED STATES DISTRICT JUDGE

APPENDIX C -- OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT FILED JUNE 30, 1995

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued May 11, 1995 Decided June 30, 1995

No. 94-5145

UNITED STATES OF AMERICA,
APPELLEE

v.

JOHN R. SPICER,
APPELLANT

Appeal from the United States District Court for the District of Columbia.
(No. 93cv01722).

Ronald L. Schwartz argued the cause and filed the brief for appellant.

David W. Long, Attorney, United States Department of Justice, argued the cause for appellee. With him on the brief were Frank W. Hunger, Assistant Attorney General, Eric H. Holder, Jr., United States Attorney, and Michael F. Hertz, Attorney.

Before: EDWARDS, *Chief Judge*; WALD and BUCKLEY, *Circuit Judges*.

Appendix C

Opinion for the Court filed by *Circuit Judge* WALD.

WALD, *Circuit Judge:* John R. Spicer appeals from a judgment of the district court holding that bankruptcy does not discharge his $339,000 debt to the United States. Spicer promised to pay this amount in settlement of the government's civil claims against him for fraud. The district court held the debt nondischargeable under 11 U.S.C. § 523(a)(2)(A), which provides that bankruptcy "does not discharge an individual debtor from any debt ... for money [or] property ... to the extent obtained by ... false pretenses, a false representation, or actual fraud." We affirm.

I. BACKGROUND

On October 3, 1989, real estate broker and investor John R. Spicer entered a guilty plea in the United States District Court for the District of Columbia on a single count of interstate transportation of money obtained by fraud. Spicer admitted that in documents submitted to the Department of Housing and Urban Development ("HUD"), he had intentionally overstated the down payment made by a home buyer in order to help the buyer qualify for an FHA-insured mortgage.

Spicer was sentenced to incarceration for four months. Although the fraud conviction was predicated upon a single transaction involving a property at 764 Howard Road, S.E., in the District of Columbia, Spicer admitted in factual stipulations that he had made similar misrepresentations on a total of 81 applications for FHA-insured mortgages in 1983 and 1984. The district court included in his sentence an order to pay restitution to the government in the amount of

$340,000, equal to the profits he earned as a result of these misrepresentations. In each case, Spicer overstated the down payment made by the buyer, who used that false information to obtain an FHA-insured mortgage. In each case, Spicer's misrepresentation was germane to HUD's determination that the buyer qualified for an FHA-insured mortgage[1]. And in each case, Spicer profited from the transaction either as the seller of the property or as the seller's broker, earning a commission on the sale. Buyers of 43 of the 81 parcels subsequently defaulted, resulting in losses of $1.8 million to HUD.

After being convicted on the criminal fraud count, Spicer reached a settlement agreement with the government on all its pending civil claims against him under the False Claims Act, 31 U.S.C. §§ 3729 et seq., and for common law fraud. Under the terms of the agreement, Spicer did not admit liability, but did promise to pay the government $339,000, plus interest at 8.5%, over a 10-year period. On October 26, 1990, Spicer executed two promissory notes to that effect. In return, the government explicitly released all its civil claims (except tax claims) against him. Once this settlement agreement was reached on the civil claims, the district court deleted the restitution order from Spicer's criminal sentence.

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[1]FHA mortgages generally require relatively small down payments. Nonetheless, a down payment is required in order to ensure that the borrower has a sufficient personal financial stake to avoid default. In the transactions at issue here, Spicer sold houses with down payments smaller than required for FHA mortgages, or in some cases no down payment at all. Spicer then intentionally misrepresented the transactions in documentation submitted to HUD, showing down payments sufficient to qualify the buyers for FHA-insured mortgages.

Appendix C

On July 29, 1992, Spicer filed a voluntary Chapter 7 bankruptcy petition, seeking, inter alia, to discharge his obligations on his promissory notes to the government. On October 29, 1992, the government filed an adversary complaint in bankruptcy court seeking a determination that the $339,000 Spicer owed to the government is not dischargeable in bankruptcy, under a provision of the Bankruptcy Code stating that bankruptcy "does not discharge an individual debtor from any debt ... for money [or] property ... to the extent obtained by ... false pretenses, a false representation, or actual fraud," 11 U.S.C. § 523(a)(2)(A). The bankruptcy court granted the government's motion for summary judgment. *In re Spicer*, 155 Bankr. 795 (Bankr. D.D.C. 1993). The district court affirmed in an unreported memorandum opinion. Spicer now appeals from that judgment.

II. ANALYSIS

A. *Nondischargeability Under 11 U.S.C. § 523(a)(2)(A)*

If Spicer's debt to the government is "debt for money [or] property ... obtained by ... fraud," it is not dischargeable in bankruptcy under the plain terms of 11 U.S.C. § 523(a)(2)(A). Both the bankruptcy court and the district court held that Spicer's debt fell under that statutory provision.

On appeal, Spicer contends that the district court erred in characterizing his debt as one "for money or property obtained by fraud." Relying principally on two Seventh Circuit cases, *Maryland Casualty Co. v. Cushing*, 171 F.2d 257 (7th Cir. 1948), and more recently *Matter of West*, 22 F.3d 775 (7th Cir. 1994), Spicer argues that because under

the settlement agreement the government expressly released its underlying tort claims for fraud, a "novation" occurred in which the parties' original rights and obligations ceased to exist and were replaced by new contractual obligations. Consequently, Spicer reasons, even if his original obligation to the government had been for money or property obtained by fraud, his post-settlement debt does not fit that description. Instead, he contends, it is just an ordinary contractual obligation--a promise to pay, made in exchange for the government's promise to forego certain legal claims. And ordinary contractual obligations, unlike debts for money or property obtained by fraud, are dischargeable in bankruptcy.

Maryland Casualty and *West* do indeed lend support to Spicer's theory. In *West*, an embezzler executed a promissory note to her defrauded employer in exchange for an express release of the employer's civil claims against her, then a short time later petitioned for bankruptcy. Applying the rule established in *Maryland Casualty*, the *West* court held the note dischargeable, explaining that "even if the obligation arising from ... [the] embezzlement would have been nondischargeable due to its fraudulent nature, no allegations of fraud surrounded the note, and the note substituted a contractual obligation for a tortious one." 22 F.3d at 777. See also *Gonder v. Kelley*, 372 F.2d 94 (9th Cir. 1967) (per curiam).

We decline to follow the *Maryland Casualty* approach, however, because in our view it improperly elevates legal form over substance. We cannot agree with a rule under which, through the alchemy of a settlement agreement, a fraudulent debtor may transform himself into a nonfraudulent one, and thereby immunize himself from the strictures of §

523(a)(2)(A). The weight of recent authority rejects the *Maryland Casualty* approach because it is contrary to the public policy embodied in § 523(a)(2)(A) of preventing fraudulent debtors from escaping their obligations at the expense of innocent defrauded creditors. The leading case is *Greenberg v. Schools*, 711 F.2d 152 (11th Cir. 1983), where the Eleventh Circuit concluded that "a debt which originates from the debtor's fraud should not be discharged simply because the debtor entered into a settlement agreement." Id. at 156 (emphasis added). Rather than looking to the current legal form of the debt, the court "should inquire into the factual circumstances behind the settlement agreement to ascertain whether ... the debt ... was derived from the alleged fraudulent conduct...." *Id.* (emphasis added).

The *Greenberg* approach has been followed in most recent decisions in the bankruptcy courts. See, e.g., *In re Marceca*, 129 Bankr. 371 (Bankr. S.D.N.Y. 1991); *In re Carnahan*, 115 Bankr. 697 (Bankr. D. Colo. 1990); *In re Bobofchak*, 101 Bankr. 465 (Bankr. E.D. Va. 1989); *In re Peters*, 90 Bankr. 588 (Bankr. N.D.N.Y. 1988); *In re Pavelka*, 79 Bankr. 228 (Bankr. E.D. Pa. 1987); *In re Kovacs*, 42 Bankr. 1 (Bankr. D. Mass. 1982); *In re Rush*, 33 Bankr. 97 (Bankr. D. Maine 1983). *But cf., e.g., In re Anderson*, 64 Bankr. 331 (Bankr. N.D. Ill. 1986). As the *Peters* court cogently explained, "dischargeability is determined by the substance of the liability, not the form." 90 Bankr. at 604.

We think the *Greenberg* approach sound because, as numerous courts have noted, it effectuates the policy Congress sought to implement when it enacted § 523(a)(2)(A). "A debtor's "fresh start' is not absolute; the

Appendix C

[Bankruptcy] Code embodies a delicate balance between the rights of debtors and the rights of defrauded creditors." *In re Pavelka*, 79 Bankr. at 232. "Although debtors are entitled under the [Bankruptcy] Code to an unencumbered fresh start, Congress has unmistakably mandated in section 523(a)(2)(A) that they may not get a fresh start at the expense of defrauded third parties." *In re Rush*, 33 Bankr. at 98 (citation omitted).

In contrast, under the *Maryland Casualty* approach "the intent of Congress to except from discharge debts incurred by fraud could effectively be shortcircuited by a simple execution of settlement. To disregard the settlement agreement and look at the underlying nature of the claim would not hinder the overall scheme of the Bankruptcy Code of giving the honest debtor a fresh start." *In re Bobofchak*, 101 Bankr. at 468 (emphasis added). The purpose of the fraud exception to the general principle of dischargeability is "to discourage fraudulent conduct and to ensure that relief intended for honest debtors does not inure to the benefit of the dishonest." *In re Wilson*, 12 Bankr. 363, 370 (Bankr. M.D. Tenn. 1981). Settlement makes the dishonest debtor no more honest, and no more entitled to the relief Congress intended to reserve for the honest debtor.

In *Matter of West*, the Seventh Circuit argued that *Greenberg* and its progeny can be reconciled with *Maryland Casualty*, and specifically criticized the bankruptcy court's decision below, *In re Spicer*, for its rejection of the *Maryland Casualty* novation theory. The *West* court reasoned that because in *Greenberg* there was no express mention that the settlement agreement included a waiver or release of the underlying fraud claim, there was no novation and the

underlying fraud claim retained its vitality. 22 F.3d at 777. The *West* court is certainly correct that the Eleventh Circuit's *Greenberg* opinion offers no details as to what was included in the settlement agreement. But the prior history of that case suggests that the settlement agreement may well have included a release of the underlying fraud claim. *See In re Schools*, 14 Bankr. 953, 955 (Bankr. S.D. Fla. 1981) (plaintiff "agreed to exchange the cause of action for the promissory note" and therefore "is not entitled to resurrect the original unliquidated, untried claim for the purpose of now finding it non-dischargeable"), *vacated and remanded sub nom. Greenberg v. Schools*, 21 Bankr. 1011 (S.D. Fla. 1982), *aff'd*, 711 F.2d 152 (11th Cir. 1983). The Eleventh Circuit itself characterized the case as one in which the "settlement agreement extinguished a claim originally arising out of fraud," 711 F.2d at 153 (emphasis added). Settlement agreements typically do involve release or waiver of the underlying fraud claim. *See In re Pavelka*, 79 Bankr. at 232 n.15 ("a party would be foolish not to include a release in a stipulated settlement of a state court action"). In any event, whether or not the settlement in *Greenberg* included an express release or waiver, in our view that case stands for a broader principle: a fraudulent debtor may not escape nondischargeability, imposed as a matter of public policy by Congress in § 523(a)(2)(A), merely by altering the form of his debt through a settlement agreement, whether or not the agreement includes an express release or waiver of the fraud claim.

The *West* court also asserts that, with the sole exception of *In re Spicer*, the bankruptcy cases following *Greenberg v. Schools* did not reach the question of whether settlement agreements including express waivers or releases of underly-

ing fraud claims constitute novations, substituting new dischargeable debts for the original nondischargeable obligations. On our reading of those cases, however, they cannot be reconciled with *Maryland Casualty*. For example, *In re Bobofchak*, 101 Bankr. at 467-68, expressly rejected the theory that novation extinguishes nondischargeability, saying that contrary to the debtor's contention that the settlement extinguished the underlying tort claim against him, a settlement never "extinguishes the bankruptcy court's responsibility to look beyond the agreement to the underlying nature and character of the debtor's original liability." Similarly, *In re Peters*, 90 Bankr. at 604, said that a "debt that originates from the debtor's fraud should not be discharged simply because the debtor has entered into a settlement ... agreement, and the debt now arises from a contract rather than a tort." *In re Pavelka*, 79 Bankr. at 232, said that although the settlement agreement "purported to release debtor from ... liability," the court would look to the nature of the underlying debt rather than the settlement agreement to determine whether the debt was dischargeable in bankruptcy. We think the courts in these cases meant what they said and said what they meant: a fraudulent debtor remains a fraudulent debtor, and debt originating in fraud remains nondischargeable even if its legal form changes under a settlement agreement.

Following *Greenberg v. Schools*, we look beyond the form of the settlement agreement to the substance of the underlying obligation, and conclude that Spicer's debt to the government did indeed "originate from" and "derive from" his fraudulent conduct. Although the subsequent settlement agreement alters the legal form of that obligation, it does not transmogrify its essential nature so as to immunize it from

the command of § 523(a)(2)(A) that debt for money or property obtained by fraud is not dischargeable in bankruptcy.

B. *Causation*

Spicer next contends the district court erred in concluding that his debt was for "property ... obtained by ... fraud" because the government failed to prove that his misrepresentations proximately caused HUD's losses on the defaulting mortgages. Spicer candidly admits that he made misrepresentations to HUD on buyers' applications for FHA-insured mortgages. It is undisputed that some of those mortgagors subsequently defaulted, and that HUD lost $1.8 million as a result. Spicer argues, however, that his misrepresentations caused HUD's injury only in an incidental "but-for" sense; the mortgagors' defaults were proximately caused by a variety of factors, such as job loss or other personal financial reversals, all beyond Spicer's control. To establish that his debt is nondischargeable due to fraud, Spicer insists, the government must prove that his misrepresentations were the proximate cause of its losses, and it has not done so here.

Proximate causation--loss or damage to the creditor "as a proximate result of" the debtor's misrepresentation--is an element that must be proved in order to establish nondischargeability under § 523(a)(2)(A). *In re Britton*, 950 F.2d 602, 604 (9th Cir. 1991). *See also In re Sestito*, 136 Bankr. 602 (Bankr. D. Mass. 1992); *In re Larson*, 136 Bankr. 540 (Bankr. D. N.D. 1992); *In re Tam*, 136 Bankr. 281 (Bankr. D. Kan. 1992); *In re Gadsden*, 128 Bankr. 45 (Bankr. E.D.N.Y. 1991); *but cf. In re Gerlach*, 897 F.2d 1048, 1051 (10th Cir. 1990) (creditor need not prove damages caused by

fraud in order to establish nondischargeability). And in general, the causation element in fraud cases demands more than mere "but-for" causation. *See Greenberg v. DeTessieres*, 284 U.S. App. D.C. 176, 902 F.2d 1002, 1004 (D.C. Cir. 1990) ("but-for" causation is not sufficient to establish common law fraud); *In re Hibbs*, 568 F.2d 347 (3d Cir. 1977) ("but-for" causation is not sufficient to establish claim under False Claims Act); RESTATEMENT (SECOND) OF TORTS § 548A (1977) (to establish fraud, fraudulent act must be a "substantial cause" of victim's loss).

For its part, the government contends that proof of causation is not necessary at all in this case, because the uncontested facts and the settlement agreement conclusively establish both the fraudulent nature of Spicer's conduct and the extent of his nondischargeable debt for purposes of § 523(a)(2)(A). The government relies on cases holding that when a prior court judgment conclusively establishes the extent of a nondischargeable debt, collateral estoppel precludes relitigation of that issue. *See, e.g., In re Comer*, 723 F.2d 737, 740 (9th Cir. 1984).

We are not persuaded that the uncontested facts and the settlement agreement in themselves establish as much as the government claims. It is certainly true, as the government asserts, that the extent of Spicer's debt to the government is conclusively determined by the settlement agreement. But Spicer does not dispute the amount of his debt; instead, he disputes the government's assertion that the entire amount of that debt has been conclusively determined to be nondischargeable due to fraud. In our view, the mere fact that the debt was in settlement of the government's (untried and unproven) fraud claims, without more, is insufficient to

establish its nondischargeability. Nor was the character of the debt as the product of Spicer's fraudulent conduct conclusively established either in Spicer's criminal conviction or in the settlement agreement. Spicer's guilty plea to one count of fraud in his criminal trial establishes at most the fraudulent nature of but a single transaction involving a single parcel of property, upon which the criminal count was predicated. That single fraud count cannot be said to conclusively establish the fraudulent nature of the other 80 transactions[2]; nor does Spicer's criminal conviction establish that his misrepresentations caused HUD's losses, the precise question raised here. We note that the factual stipulations in the criminal case, in which Spicer admitted to making misrepresentations in 80 additional transactions without admitting that his conduct amounted to fraud, pointedly reach no conclusion as to whether the ultimate "defaults and foreclosures" were the "result of the conduct with which Mr. Spicer was as-

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[2]In *Brown v. Felson*, 442 U.S. 127, 60 L. Ed. 2d 767, 99 S. Ct. 2205 (1979), the Supreme Court held that in considering the nondischargeability of a debt, a bankruptcy court may consider all the relevant evidence, and is not barred by res judicata from considering evidence extrinsic to the judgment and record of a prior state court proceeding concerning the debtor's obligation to his creditor. The Court declined to reach the question of whether collateral estoppel would apply to bar relitigation of issues actually and necessarily decided in the prior proceeding, *e.g.*, that the debtor had committed fraud. *Id.* at 139 n.10.

Like the Supreme Court in *Brown v. Felson*, we need not decide whether collateral estoppel applies. We conclude only that even if Spicer's fraud conviction conclusively determines the fraudulent nature of the single transaction involved there, it surely does not determine that the 80 transactions not directly at issue in that case were also fraudulent.

sociated." Appellant's Appendix ("App.") 13-14. We further note that in recitals in the settlement agreement on the civil fraud claims, Spicer expressly denies "liability, legal fault, or responsibility" for any losses to the government. App. 1. Thus neither the criminal proceeding nor the settlement agreement can be said to conclusively establish that all of Spicer's misrepresentations amounted to fraud. Nor do they establish that Spicer's misrepresentations proximately caused the government's losses, an essential element of nondischargeability.

Nonetheless, we think the requisite element of proximate causation was established by the courts below. The bankruptcy court addressed the question of causation as follows:

> In arguing that the defaulting mortgagors caused the government's losses, the debtor seeks to avoid responsibility for his actions.... The government program at issue here required by law that the mortgagor make a downpayment as a pre-condition to obtaining federal mortgage insurance. Thus, absent the debtor's false statements, the government would never have been called upon to pay off the mortgages. The debtor is not entitled to escape or limit liability by laying the blame for the government's losses on the defaulting mortgagors where his false statements resulted in the government agreeing to insure the mortgages in the first place.

In re Spicer, 155 Bankr. at 803. Although Spicer cites this statement as evidence that the bankruptcy court erroneously adopted a "but-for" standard of causation, we read it somewhat more broadly. Admittedly the language of the third

sentence ("absent the debtor's false statements, the government would never have been called upon ....") seems to stop at "but-for" causation, but the rest of the passage, especially the final sentence ("false statements resulted in the government agreeing ...) (emphasis added), is consistent with proximate causation. A fair reading of the entire statement is that it recognizes some causal nexus between Spicer's misrepresentations and the government's losses, without specifying the precise nature of that causal relationship.

The district court recognized this ambiguity in the bankruptcy court's statement:

> The Bankruptcy Court appears to have adopted a "but-for" test for causation in this case, yet this passage implicitly recognizes that appellant's misrepresentations were a substantial causal factor of the government's loss.... Without choosing a definitive test for causation, the Court holds that a sufficient nexus between Spicer's misrepresentation and monetary losses to the government has been demonstrated in this case.

Memorandum Opinion at 5-6, App. 29-30.

The district court thus identifies the ambiguity in the bankruptcy court's statement, and, crucially, goes on to clarify that, based on the undisputed facts, Spicer's misrepresentations caused HUD's losses in a legally sufficient sense--even if the stricter standard of proximate causation applies.

We agree with Spicer that proof that his misrepresentation proximately caused harm to the government is required

in order to establish the fraudulent nature of his debt for purposes of § 523(a)(2)(A). Applying that standard, the district court concluded that Spicer's misrepresentations proximately caused HUD's losses. Spicer's misrepresentations were material to HUD's determination that the mortgage applicants met the financial requirements to qualify for FHA-insured mortgages and had a sufficient personal financial stake in the properties to have the proper incentives to avoid default. The misrepresentations were thus more than a "but-for" cause; they proximately caused HUD's losses when the buyers to whom HUD improvidently granted FHA-insured mortgages on the basis of Spicer's misrepresentations of their financial qualifications defaulted. The defaults were thus a foreseeable consequence of Spicer's conduct. It is undoubtedly true that in each case other factors also "caused" the buyer's default, but that is of no moment, for as long as Spicer's misrepresentations were a material and proximate cause, they need not have been the sole factor causing HUD's losses. *See In re Sobel*, 37 Bankr. 780, 786 (Bankr. S.D.N.Y. 1984). *See also In re Gerlach*, 897 F.2d at 1052 ("a debt is "obtained by' fraud if the fraud is a substantial factor in the creditor's decision").

Spicer cites prior cases in which no proximate causation was found, but these are easily distinguished on the facts. For example, in *United States v. Hibbs*, 568 F.2d 347 (3d Cir. 1977), the seller of residential properties made false certifications on FHA loan applications concerning the properties' heating, plumbing and electrical systems. Those misrepresentations were held not to be a material cause of HUD's losses when the buyers defaulted, even though they were a "but-for" cause in the sense that HUD would not have approved the loans absent the certifications. In that case,

however, the certifications were merely an ancillary requirement, not material to HUD's determination that the borrowers were financially qualified or had a sufficient personal financial stake in the property to be unlikely to default. As the Fifth Circuit later noted in *United States v. Miller*, 645 F.2d 473 (5th Cir. 1981), "false statements regarding the ability of purchasers to afford housing could very well be the major factor [causing] subsequent defaults," and thus *Hibbs* does not preclude a fraud claim against a developer who misrepresented buyers' down payments. Similarly, we conclude that *Hibbs* does not preclude the determination by the district court that the seller's (or broker's) misrepresentation of the buyers' down payments was a proximate cause of the guarantor's loss when the buyers subsequently defaulted on their mortgages.

Because this case was decided below on a motion for summary judgment, we must review the decision to grant summary judgment *de novo*. *In re Varrasso*, 37 F.3d 760, 763 (1st Cir. 1994) (district court reviews bankruptcy court's grant of summary judgment *de novo*, and court of appeals applies same standard in reviewing district court's affirmance); *Rosen v. Bezner*, 996 F.2d 1527, 1530 & n.2 (3d Cir. 1993) (same). Summary judgment in bankruptcy is governed by Bankruptcy Rule 7056, which incorporates the standard of Rule 56 of the Federal Rules of Civil Procedure: summary judgment may be granted only if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Varrasso*, 37 F.3d at 762-63. On a motion for summary judgment, "all inferences to be drawn ... must be viewed in the light most favorable to the party opposing the motion." *Matsushita Elec. Indus. Corp. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1985). A

genuine issue of material fact exists "if the evidence is such that a reasonable jury could return a verdict for the non-moving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986).

In this case, the underlying facts are undisputed. From those facts, the district court determined that Spicer's misrepresentations were a proximate cause of HUD's subsequent losses. But "if, based on the record, inferences contrary to those drawn by the trial court are also plausible, summary judgment must be reversed." *Santiago v. Lane*, 894 F.2d 218, 223 (7th Cir. 1990) (citation omitted). Here, Spicer adduced no evidence supporting an inference contrary to that reached by the court below. Instead he argues only that as a matter of law his misrepresentations could not have been the proximate cause of HUD's losses. As we have demonstrated, however, Spicer's legal argument is without merit. Once that legal barricade falls, it follows ineluctably that Spicer's misrepresentations must have been the proximate cause of HUD's losses. It is undisputed that Spicer intentionally misrepresented buyers' downpayments in order to induce HUD to approve FHA-insured mortgages for parties who otherwise would not qualify; without evidence of adequate down payments, HUD would have rejected the applications, calculating the risk of default too high. HUD went for Spicer's bait, and suffered massive losses when those buyers subsequently defaulted. Viewing all the evidence in the light most favorable to Spicer, we think a rational factfinder could only conclude from the undisputed facts that Spicer's misrepresentations did indeed proximately cause HUD's losses. *See In re Varasso*, 37 F.3d at 764 (court may not choose between "conflicting but plausible inferences" on summary judgment, but if "undisputed facts ... point unerring-

ly to a single, inevitable conclusion," summary judgment is warranted); *cf., e.g., In re Batie*, 995 F.2d 85, 90 (6th Cir. 1993) (affirming bankruptcy court's ruling on summary judgment that debt was nondischargeable; undisputed facts established debtor's "intent to deceive" because "no rational jury could find" otherwise). We therefore affirm the conclusion of the district court, that the undisputed facts demonstrate that Spicer's misrepresentations proximately caused HUD's losses.

C. *Extent of Debt Obtained by Fraud*

Spicer finally contends that the district court erred by assuming that the entire amount of his debt was nondischargeable, when some (or all) of it was punitive in nature. Section 523(a)(2)(A) says that debts "for money [or] property ... to the extent obtained by" fraud are nondischargeable. 11 U.S.C. § 523(a)(2)(A) (emphasis added). Thus only that portion of a debt attributable to the debtor's fraud is nondischargeable. *In re Church*, 69 Bankr. 425, 435 (Bankr. N.D. Tex. 1987). *But cf. In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993) (nondischargeability is an "all-or-nothing" proposition). Spicer contends that there was no showing here that the amount of the settlement reflects "the extent of" the government's "actual pecuniary loss" as a result of his fraudulent actions. Appellant's Brief at 29. In particular, Spicer contends that at least part of the settlement amount is "punitive" and therefore not subject to § 523(a)(2)(A).

Courts are divided on the question of whether punitive damages awarded in fraud cases are nondischargeable. Compare *In re St. Laurent*, 991 F.2d at 672 (punitive damages portion of fraud judgment is nondischargeable) and

Appendix C

In re Manley, 135 Bankr. 137 (Bankr. N.D. Okla. 1992) (same), with *In re Levy*, 951 F.2d 196 (9th Cir. 1991) (punitive damages are dischargeable), *cert. denied*, 504 U.S. 985, 119 L. Ed. 2d 586, 112 S. Ct. 2965 (1992) and *In re Elhwanger*, 105 Bankr. 551, 556 (9th Cir. BAP 1989) (same). In this case we need not decide whether punitive damages are dischargeable, however, for there is no basis for Spicer's assertion that his debt, or any part of it, represents punitive damages. Unlike the cases Spicer cites, in this case no punitive damages were awarded. It is undisputed that the government's actual losses--which were proximately caused by Spicer's misrepresentations, *see supra* Part II.B.--were $1.8 million, a figure far exceeding the $339,000 settlement figure. The $339,000 debt in this case is neither pure punishment nor punitive damages added on to a compensatory damages award. It is instead the amount the government agreed to accept in lieu of pursuing civil fraud claims under which, if successful, it might have recovered $1.8 million in actual damages, and perhaps even more under the False Claims Act which allows for a doubling or trebling of damages. That the government settled for less than it might have garnered had it successfully pursued its claims in court certainly does not make the debt punitive in character.[3] And although the

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[3]Spicer argues that because the $339,000 settlement figure equals his net proceeds from the 81 fraudulent transactions, this somehow establishes that the settlement amount is unrelated to the government's losses. But the government could have agreed to settle its fraud claims for any amount, determined by any method or no method at all. It could have chosen Spicer's net worth, some factor of his income-earning potential, or a purely arbitrary figure acceptable to the parties. The fact that it chose a figure based on Spicer's net proceeds does not convert the settlement into punishment.

settlement figure closely corresponds to the $340,000 restitutionary amount originally ordered (and subsequently deleted) as part of Spicer's criminal sentence, there is simply no basis for assuming that the "punitive" character of the criminal sentence somehow transfers to the settlement of the government's civil fraud claims.

The bankruptcy court reasoned that the entire amount of the settlement agreement, $339,000, was a "debt" for "money or property ... obtained by ... fraud," insofar as the debt resulted entirely from Spicer's fraudulent conduct. The relevant "property" was, in this case, the FHA mortgage guarantees, which Spicer secured for third parties. See *In re Sprague*, 104 Bankr. 352, 355 (Bankr. D. Ore. 1989) (fraudulently obtained loan guarantees are "property" for purposes of § 523(a)(2)); *see also Chernick v. United States*, 492 F.2d 1349 (7th Cir. 1974) (reaching similar conclusion under predecessor statute). This case, the bankruptcy court noted, is plainly distinguishable from the cases cited by Spicer, *e.g.*, *In re Carnahan*, 115 Bankr. 697, and *In re Bobofchak*, 101 Bankr. 465, in which courts had to apportion settlements between nondischargeable fraud claims, and dischargeable non-fraud claims. 155 Bankr. at 800-01. The district court concurred in this analysis.

We agree with the conclusion of the courts below, even while recognizing that there is arguably some ambiguity in the phrase "debt ... for money [or] property ... to the extent obtained by .... fraud." Some courts have said that "to the extent obtained by fraud" modifies "debt," so that if the debt is "obtained by" the debtor's fraudulent conduct it is nondischargeable. *See, e.g., In re Levy*, 951 F.2d at 198. Other courts have said that "to the extent obtained by fraud"

modifies "money or property," so that the debt is nondischargeable to the extent the money or property was "obtained by" the debtor's fraud. *See, e.g., In re Manley*, 135 Bankr. at 145. But in many cases, including the present one, there is no practical difference between these two formulations, for both will produce the same result. All of Spicer's debt was obtained by fraud, in the sense that the entire debt originated in Spicer's fraudulent misrepresentations. And all of Spicer's debt is for property obtained by fraud--the fraudulently-obtained FHA loan guarantees. We conclude that on either interpretation, Spicer's $339,000 debt to the government was in its entirety attributable to his fraudulent conduct, and therefore nondischargeable.

III. CONCLUSION

Because John R. Spicer's $ 339,000 debt to the United States is in its entirety debt for money or property obtained by fraud, under 11 U.S.C. § 523(a)(2)(A) it is nondischargeable in bankruptcy. The judgment of the district court is affirmed.

It is so ordered.

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No. 95-516

In the Supreme Court of the United States

OCTOBER TERM, 1995

JOHN R. SPICER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the government's acceptance of petitioner's promise to pay $339,000 over time to settle the government's charges against him under the False Claims Act, 31 U.S.C. 3729, and for common law fraud transformed what was a nondischargeable "debt * * * for money [or] property * * * obtained by * * * fraud" under Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A), into an ordinary contract debt that could be discharged fully through petitioner's later bankruptcy.

2. Whether the court of appeals erred in finding that petitioner's fraudulent misrepresentations were a proximate cause of the government's losses.

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In the Supreme Court of the United States

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JOHN R. SPICER, PETITIONER

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 26-46) is reported at 57 F.3d 1152. The opinion of the district court (Pet. App. 19-25) is unreported. The opinion of the bankruptcy court (Pet. App. 1-18) is reported at 155 B.R. 795.

JURISDICTION

The judgment of the court of appeals was entered on June 30, 1995. The petition for a writ of certiorari was filed on September 27, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The federal government, through the Federal Housing Administration (FHA), insures certain mortgages. 12 U.S.C. 1709(b). By statute and regulation, to be eligible for an FHA-insured mortgage, a home buyer must make a minimum down payment of at least three percent of the cost of the property. Pet. App. 2. The minimum down payment is required in order to demonstrate the buyer's financial qualifications and to ensure that the buyer has a personal financial stake in avoiding default and consequent loss to the federal government. *Id.* at 28 n.1, 40.

2. In October, 1989, petitioner pled guilty to one count of interstate transportation of money obtained by fraud, in violation of 18 U.S.C. 2314. In his factual proffer, petitioner, a real estate broker and investor, admitted that, from 1983 through 1984, he falsely represented to the Department of Housing and Urban Development (HUD) that the buyers in 81 of his sales transactions made down payments sufficient to qualify for FHA-insured mortgages. Petitioner admitted further that he intentionally overstated the buyers' down payments for the purpose of inducing HUD to provide mortgage insurance on the loans. The buyers of 43 of the 81 parcels eventually defaulted on their loans, resulting in losses of $1.8 million to the government. Petitioner was sentenced to four months' incarceration and was ordered to pay restitution to the government of $340,000, an amount equal to the total profits he had earned as a result of the 81 sales. Pet. App. 3, 27-28.

After his conviction, petitioner and the government executed a settlement agreement regarding the government's pending civil claims under the False

Claims Act, 31 U.S.C. 3729 *et seq.*, and for common law fraud. Pet. App. 28. The agreement recited the government's contention "that [petitioner] * * * caused the submission to HUD of * * * false applications for HUD mortgage insurance, and is liable for losses sustained in connection with claims for HUD mortgage insurance benefits submitted by [the] mortgage holders." *Id.* at 3. Petitioner did not concede liability, but he promised in the agreement to pay the government $339,000, plus interest at 8.5%, over a ten-year period in exchange for the government's release of all of its civil claims (except tax claims) against him. *Id.* at 28.[1]

3. On July 29, 1992, petitioner filed a voluntary petition under Chapter 7 of the Bankruptcy Code in the United States District Court for the District of Columbia, seeking, among other things, to discharge his debt to the federal government. The United States, in response, sought a determination that petitioner's debt for $339,000 was excepted from discharge under Section 523(a)(2)(A) of the Code, 11 U.S.C. 523(a)(2)(A). Pet. App. 29. The bankruptcy court granted the government's motion for summary judgment, *id.* at 1-18, and its judgment was affirmed on appeal by the district court, *id.* at 19-25.

4. The court of appeals affirmed. Pet. App. 26-46. The court rejected the approach followed by the Seventh Circuit in *Maryland Casualty Co.* v. *Cushing*, 171 F.2d 257 (1948), and *In re West*, 22 F.3d 775 (1994), and the Ninth Circuit in *Gondor* v. *Kelley*, 372 F.2d 94 (1967) (per curiam), that a settlement

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[1] Once the settlement became final, the district court deleted the restitution order from petitioner's criminal sentence. Pet. App. 28.

agreement effects a "novation" through which a nondischargeable debt for "money [or] property * * * obtained by * * * fraud," 11 U.S.C. 523(a)(2)(A), is replaced by an ordinary contractual obligation that is dischargeable in bankruptcy. Pet. App. 29-30. In the court's view, that approach—"under which, through the alchemy of a settlement agreement, a fraudulent debtor may transform himself into a nonfraudulent one"—is not compelled by the text of Section 523(a)(2)(A) and "improperly elevates legal form over substance." Pet. App. 30.

The court sided instead with the weight of recent authority, agreeing with *Greenberg* v. *Schools*, 711 F.2d 152, 156 (11th Cir. 1983), that, where a debtor seeks to discharge an amount due under a settlement, the relevant "debt" is the obligation that gave rise to the settlement. See Pet. App. 30-31 (citing cases). Looking behind the settlement agreement to the underlying nature of the claim "would not hinder the overall scheme of the Bankruptcy Code of giving the *honest* debtor a fresh start," and would better effectuate Congress's intention, through Section 523(a)(2)(A) "to discourage fraudulent conduct and to ensure that relief intended for honest debtors does not inure to the benefit of the dishonest." Pet. App. 32 (emphasis added).

The court also rejected petitioner's claim that his fraudulent misrepresentations were not the proximate cause of the government's losses on the defaulted mortgages. Pet. App. 35-43. The court agreed with petitioner that proof of fraud "requires more than mere 'but-for' causation," *id.* at 35-36, but it concluded that, since petitioner's misrepresentations implicated both the buyers' financial wherewithal and their incentives to avoid default, the

government's losses from the buyers' eventual defaults derived foreseeably from petitioner's conduct, *id.* at 40.

ARGUMENT

1. The court of appeals' holding that an obligation owed under a settlement agreement is nondischargeable if the debt underlying the settlement was incurred by fraud is in square conflict with the Seventh Circuit's approach in *West* and *Maryland Casualty*, and with the Ninth Circuit's decision in *Kelley*. Moreover, the issue is one of considerable importance. We do not believe, however, that certiorari is warranted at this time.

The court of appeals' decision in this case was correct, and its interpretation of Section 523(a)(2) is consistent with this Court's interpretation of that Section's Bankruptcy Act precursor in *Brown* v. *Felsen*, 442 U.S. 127 (1979). The court of appeals' holding is, moreover, consistent with the clear weight of recent authority. The Ninth Circuit has not revisited the issue presented in this case since *Felsen*, and while *Kelley* remains on the books, its precedential value is open to question—leaving the Seventh Circuit as the only jurisdiction that indisputably disagrees with the holding below.

a. Petitioner concedes that he intentionally misled the government when he falsely stated that the buyers had made legally sufficient down payments. He does not dispute the lower courts' findings that HUD reasonably relied on his misrepresentations and that the government suffered losses of approximately $1.8 million when the buyers defaulted on their mortgage obligations. Petitioner argues (Pet. 6-9), however, that the debt that he owes to the

government under the settlement agreement is dischargeable, because the government's fraud claim was extinguished by virtue of the release. That argument is incorrect.

Section 523(a)(2)(A) excepts from discharge "*any* debt * * * for money [or] property * * * obtained by * * * fraud." 11 U.S.C. 523(a)(2)(A) (emphasis added). Petitioner in this case obtained property—FHA mortgage insurance—by fraud. The debt arising from the settlement agreement is an obligation to repay part of the value of that fraudulently obtained property. Nothing in the language of the settlement agreement in this case, or in the general nature of settlement, suggests that the government gave up its right to demonstrate in a subsequent bankruptcy proceeding that petitioner's debt "was derived from [his] alleged fraudulent conduct." *Greenberg*, 711 F.2d at 156.

Maintaining the focus of the inquiry on the underlying nature of the claim is consistent with Congress's desire to "limit[] the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.'" See *Grogan* v. *Gardner*, 498 U.S. 279, 286-287 (1991). That interest would not be served by permitting an obligation that originated in the debtor's fraud to be discharged simply because the debtor entered into a settlement agreement. As the court of appeals observed, "[s]ettlement makes the dishonest debtor no more honest, and no more entitled to the relief Congress intended to reserve for the honest debtor." Pet. App. 32.

b. The approach adopted by the court below is consistent with that taken by the Eleventh Circuit in

Greenberg,[2] and with the decisions of bankruptcy courts in five other circuits that have followed *Greenberg*. See *In re Turner*, 179 B.R. 273, 276-277 (Bankr. D. Colo. 1995); *In re Guerrerio*, 143 B.R. 605, 611 (Bankr. S.D.N.Y. 1992); *In re Bobofchak*, 101 B.R. 465, 467-468 (Bankr. E.D. Va. 1989); *In re Pavelka*, 79 B.R. 228, 232 (Bankr. E.D. Pa. 1987); *In re Rush*, 33 B.R. 97, 98 (Bankr. D. Me. 1983); *In re Kovacs*, 42 B.R. 1, 3 (Bankr. D. Mass. 1982).

The court of appeals' holding is also strongly supported by this Court's decision in *Brown* v. *Felsen*, *supra*. In that case, a creditor who had pursued both fraud and contract claims ultimately obtained a consent judgment that did not specify the grounds for the debtor's liability. When the debtor later filed for relief in bankruptcy, the creditor objected to discharge of the judgment debt. This Court held that, in resolving the dispute as to

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[2] Contrary to petitioner's claim (Pet. 6), the settlement agreement in *Greenberg* was construed as incorporating a complete release of the outstanding fraud claims, see Pet. App. 33, and the court of appeals in that case firmly rejected the argument that the release barred inquiry into the nature of those underlying claims:

> [A] debt which originates from the debtor's fraud should not be discharged simply because the debtor entered into a settlement agreement. The underlying debt was unquestionably the result of the debtor's fraud, not his breach of the settlement agreement. The fact that [the creditor's] claim never matured into a final judgment but was terminated by a settlement agreement should not be controlling. The Bankruptcy Court should inquire into the factual circumstances behind the settlement agreement to ascertain whether or not the debt incurred * * * was derived from the alleged fraudulent conduct * * *.

Greenberg, 711 F.2d at 156.

dischargeability, the bankruptcy court should look behind the judgment to the nature of the underlying debt.[3]

The factors that this Court found dispositive in *Felsen* apply with equal force in the present case. The debtor argued in *Felsen* that, because the creditor failed to pursue the fraud claim to final judgment or to obtain a stipulation expressly conceding fraud, the creditor was barred by res judicata from raising allegations of fraud in the later bankruptcy proceedings. 442 U.S. at 132. See also Restatement (Second) of Judgments § 18 cmt. a; *id.* §§ 17-18 (1982) (upon entry of judgment, underlying claims are extinguished through merger). Just as the release in this case left the government solely with an action to enforce the settlement agreement, the doctrine of res judicata left the creditor in *Felsen* solely with an action to enforce the judgment. This Court concluded in *Felsen*, however, that, for purposes of discharge, the key was not the type of legal action, but instead the "true nature of the [underlying] debt." 442 U.S. at 138. Absent prior judicial findings, the Court said, the bankruptcy court must resolve for itself whether the debtor "in fact committed the deceit." *Ibid.* See also *In re Daley*, 776 F.2d 834 (9th Cir. 1985), cert. denied, 476 U.S. 1159 (1986).

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[3] When *Felsen* was decided, discharge was governed by Section 17 of the Bankruptcy Act, 11 U.S.C. 35 (1976), a provision "substantially similar" to Section 523(a)(2) of the present Bankruptcy Code. *Felsen*, 442 U.S. at 129 n.1. "[N]o reason exists why the rationale of the [*Felsen*] decision should not be utilized in dealing with cases under Section 523(a)(2)." *In re Daley*, 776 F.2d 834, 836 n.5 (9th Cir. 1985), cert. denied, 476 U.S. 1159 (1986).

The Court found its interpretation consistent with Congress's desire to limit the "fresh start" to the "honest but unfortunate debtor." *Felsen*, 442 U.S. at 128. "By seeking discharge," the debtor "place[s] the rectitude of his prior dealings squarely in issue," because the bankruptcy court "may not [afford] a discharge [to a debtor who] has committed certain crimes or offenses," including, under Section 523(a)(2)(A), obtaining money or property through fraud. 442 U.S. at 128-129.

The Court found further support in the legislative history of the bankruptcy statutes. See *Felsen*, 442 U.S. at 138. It noted that the 1898 Bankruptcy Act originally excepted from discharge only "judgments" sounding in fraud. *Ibid.* That provision was amended in 1903 through the substitution of "liabilities" for "judgments," so as "to exclude beyond peradventure certain liabilities growing out of offenses against good morals." *Ibid.* (quoting H.R. Rep. No. 1698, 57th Cong., 1st Sess. 3, 6 (1902)). Congress's desire to reach all liabilities incurred through fraud suggested that "all debts arising out of [fraudulent] conduct * * * should be excepted from discharge," regardless of whether the original debt had been transformed by a "conscientious creditor," prior to bankruptcy, into some other form, such as a consent judgment. *Ibid.*

Finally, this Court rejected as impracticable the suggestion that, to preserve his objection to discharge in the event of the debtor's future bankruptcy, a creditor must in all pre-bankruptcy lawsuits litigate to final judgment the nature of the underlying debt. That alternative would force courts to decide questions of fraud "at a stage when they are not directly at issue and neither party has a full incentive to litigate them." *Felsen*, 442 U.S. at 134. As this

Court noted, "[i]t makes little sense * * * to resolve a * * * dischargeability question according to whether or not the parties * * * waived their right to engage in hypothetical litigation." *Id.* at 137. As this Court recognized, it is eminently reasonable for a creditor to seek a non-fraud remedy in order to resolve a matter expeditiously. *Id.* at 137 n.8.

c. Although the Ninth Circuit's holding in *Kelley* is at odds with the decision below, it is unclear whether *Kelley* remains good law. More recently, in *Daley*, creditors who had stipulated to a dismissal of their fraud claims after being granted summary judgment on their contract claims sought to prevent discharge of the contract judgment in bankruptcy. Looking to the guidance provided by this Court in *Felsen*, a panel of the Ninth Circuit held that the creditors were not foreclosed by res judicata or collateral estoppel, 776 F.2d at 837-838, and it directed the bankruptcy court to "consider all relevant evidence bearing on the nature of the debt" underlying the judgment, *id.* at 839. The panel in *Daley* did not advert to the Ninth Circuit's earlier decision in *Kelley*, and it would be difficult to reconcile the two cases. It would not seem to make a difference for purposes of discharge in bankruptcy whether a fraud claim was extinguished by a dismissal with prejudice (as in *Daley*) or by a release (as here). *Daley* therefore casts considerable doubt on *Kelley's* continuing vitality.

That leaves the Seventh Circuit, which in *West* recently reaffirmed its holding in *Maryland Casualty* and specifically criticized the analysis of the bankruptcy court in the present case. In our view, the position taken by the Seventh Circuit, based on that Circuit's pre-*Felsen* precedent, does not

require certiorari review of the correct decision in this case, which is in line with the clear direction of lower court authority. The issue is important, however, and review may well be indicated if a more significant split develops among the courts of appeals.

2. Petitioner argues (Pet. 9-11), in addition, that the court of appeals erred in concluding that the record supported the bankruptcy court's finding that petitioner's misrepresentations proximately caused the government's losses. The court correctly applied the law to the particular facts of this case, however, and its decision in this case does not conflict with the decision of any other court of appeals.

The court of appeals recognized that more than mere "but-for" causation is required to prove fraud for purposes of Section 523(a)(2)(A), Pet. App. 35-36, but it correctly found that petitioner's misrepresentations concerning the amount of the buyers' down payments—information that went to the buyers' financial wherewithal and their incentives to avoid default—proximately caused the losses suffered by the government in honoring its mortgage insurance obligations, *id.* at 42.

Contrary to petitioner's claim (Pet. 10-11), the court's ruling in that regard was not inconsistent with the holdings in *United States* v. *Hibbs*, 568 F.2d 347 (3d Cir. 1977), or *United States* v. *Miller*, 645 F.2d 473 (5th Cir. 1981). *Hibbs* involved a suit against a real estate broker under the False Claims Act based on his submission of false certifications concerning the properties' compliance with FHA requirements for plumbing, heating, and electricity. In that case, the court held that the false statements were not proximately related to the government's insurance losses, because those losses were caused by the

buyers' defaults, not by any deficiencies in the homes' plumbing, heating or electrical systems. 568 F.2d at 351. The court specifically distinguished *United States* v. *Veneziale*, 268 F.2d 504 (3d Cir. 1959), a guaranteed loan case in which the false representation arguably had some relevance to the creditworthiness of the borrower. See *Hibbs*, 568 F.2d at 352. *Miller* affirmatively supports the decision below. In that case, the court of appeals reversed the district court's dismissal of a False Claims Act complaint that alleged misrepresentations concerning the purchasers' creditworthiness, net worth, and down payments. 645 F.2d at 476 & n.3.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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